RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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April 4, 2001 **LETTER 1316**

March 16, DJIA 9823.41; PTI 5232; A-D Ratio –5.01
March 23, DJIA 9504.78; PTI 5228; A-D Ratio –5..48
March 30, DJIA 9878.78; PTI 5244; A-D Ratio –5.01
***Dow Times Book Value: +6.03**
***Percentage of Undervalued Blue-chips: 7%**
***Gold 34-day MA: 264 Dow yield: 1.78; Dow p/e: 19.9**

THE PICTURE – Investors seem to think that as long as they hold their stocks "for the long run" everything will be fine. Sure, there may be moments of tension, sure there may be times when you wish you'd have sold some of your holdings, but "in the long run, stocks go up -- well don't they? Yeah, hold for the long run." The problem is, as Lord Keynes put it, "In the long run, we're all dead."

So what about the long run? In 1929 the Dow topped out in September at 381. By July of 1932, the Dow was down to 42. It took 25 years, from 1929 to late-1954, for the Dow to better its 381 high.

I well remember those days in the early '50s. And frankly, most of us thought that we'd never see the day when the Dow would again scale "those fantastic highs of 1929." It took a quarter of a century, but yes, the Dow finally did it.

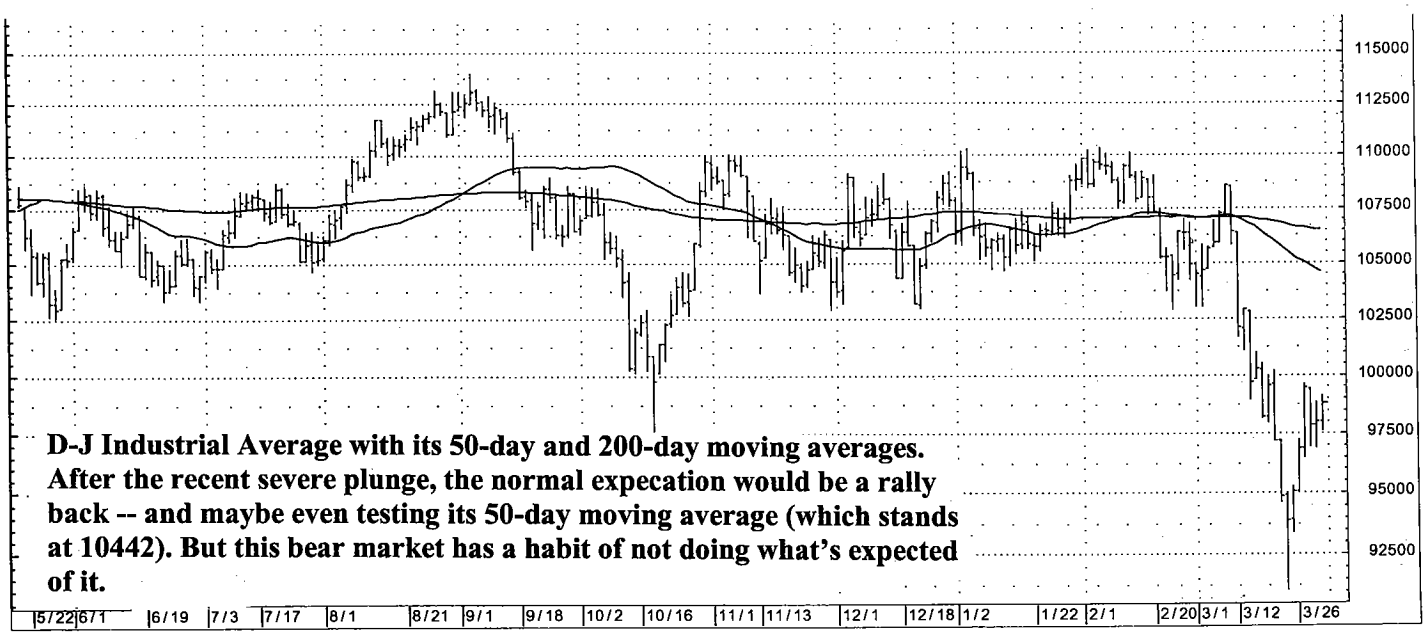
The next major top came in 1966. The Dow bounced up and down between just over 1000 down to the 700s and finally down to 577 in 1974. After the 1973-74 collapse, it wasn't until 1982 that the Dow finally moved out above 1000 again. So that was a little wait of over 16 years before the Dow could break out above its 1966 high.

Now we have a record Dow high of 11722.98 struck in January of 2000. A lot of stocks have hit the deck since then, and the bear market is far from over. How long will it be before the Dow and maybe most stocks make it back to better those January 2000 highs? It could be quite a while – and sadly, a goodly number of stocks have died, visited the graveyard, even before the return trip begins.

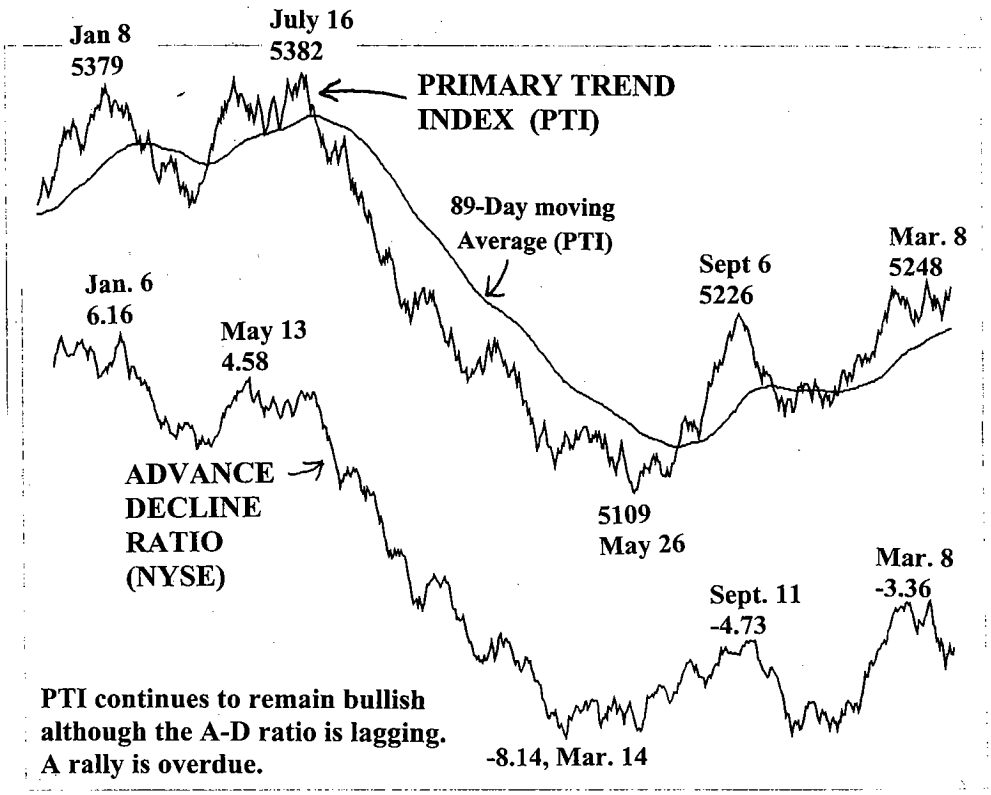
Will investors who are "in for the long haul" be willing to wait to get even- wait three years, five years, 10 years or 16 ½ years as was the case after 1966-74, or 25 years as was the case after 1929-32?

Obviously, no one knows, but it does bring up some interesting thoughts. So for those holding on "for the long term" to get their money back, I wish I could tell them what the long term is going to be. But I can't.

Me, I'm not waiting. I'm out of the stock market, and well – yes, I am waiting. But what I'm waiting for is the next bear market bottom. Even that could be a tedious wait.



D-J Industrial Average with its 50-day and 200-day moving averages. After the recent severe plunge, the normal expecation would be a rally back -- and maybe even testing its 50-day moving average (which stands at 10442). But this bear market has a habit of not doing what's expected of it.



As the great Kris Kristofferson song goes, "Yesterday is dead and gone, and tomorrow's out of sight." In this business, tomorrow's really out of sight.

On my daily Internet site I talked about bull and bear markets and their "hooks." The hook is the vehicle or phenomenon that allows you to overstay in a bear market and stay out during a bull market. The hook is the thief who frustrates you in a bull market and who costs you in a bear market.

What is the hook in this bear market? I believe there were two hooks. The first hook was the Dow, which held up even as the Nasdaq fell apart, even as the Nasdaq cost people trillions of dollars in losses. "Hey, things aren't so bad, the Dow is only down 18% from its high. What, me worry?" Yep, the Dow was the first hook.

The second hook was the breadth, the advance-decline ratio. From its bull market high on April 3, 1998, the A-D ratio fell to a March 2000 low of minus 8.14. That was a huge drop of over 21 points. From the March 2000 low the A-D ratio headed higher. "Hey, the breadth is rising. I can't sell my stocks because the breadth tells me that a 'stealth' bull market is in force."

The A-D ratio continued higher until March 8, 2001. At that point the A-D ratio had rallied to minus 3.36, a rise of 4.78 points. So the A-D ratio had corrected 4.78 points of its 21.14 point decline, a correction of 22.6%.

That was the second hook. Amateur technicians took the 22.6% correction by the advance-decline ratio as the proof that the primary trend had turned up and that a new bull market had started. Sorry, wrong interpretation.

General (but belated) agreement among economists is that there are three main problems now facing the US.

(1) Americans' addiction to over consumption. The US public has just spent and spent and spent. And for the first time, the US savings rate has gone negative.

(2) Debt. The US is now loaded to the gills with debt. During the single year 2000 corporate debt shot up by $447 billion and consumer debt exploded by $573 billion. With business turning down, private debt relative to the GDP is at its highest level in history.

(3) Corporations have over-invested in capital goods. They just got too enthusiastic. It was widely stated that there is no such thing as a tech cycle. Techs were to grow forever. Didn't work out that way.

But the main argument now is that Fed policy WILL work, lower rates, copious quantities of money, and a tax cut all will turn the US economy up by year-end. That's the theory. That's the story every bullish economist and fund manager espouses. Will it work? It always has. We'll see.

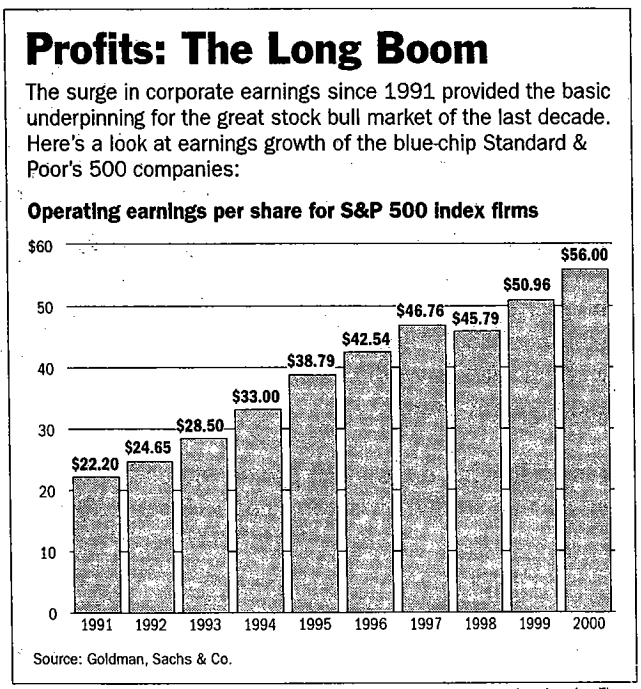
And if it starts to work, won't inflation heat up again? After all, Alan Greenspan's answer to every problem has been to re-inflate the economy. Can he do it again and not trigger inflation? And if he triggers inflation, what happens to the dollar? After all, the dollar has held up in the face of chronic trade and current account deficits. Can the dollar hold up in the face of inflation too?

One thing is clear, and I've said this maybe a hundred times. When the market turns bearish, when business starts to sag, the Fed will fight the winds of recession "tooth and nail." Which is exactly what we're seeing now. But what happens when the Fed tries to bring back the excess? What happens when the Fed moves to re-inflate the balloon? That's the fascinating question which I've been pondering. The story will be told by the market and more specifically by the averages.

The Russell opinion. One way or another, the bear market will fully express itself. The Fed may extend the bear market, the Fed may hold off the fateful final bottom for many months or even for years. But that's all the Fed will be able to do – hold off the ending.

But the Fed won't erase the natural forces, and the Fed won't turn the tide. The tide has turned down, and it will ultimately take the market down, down, down until prices are attractive enough so that large interests will move in and accumulate serious quantities of equities.

What really happened to pull the bottom out of stocks during 2000 and 2001? This chart goes a long way toward telling the story. After 1981 operating earnings for the widely-followed S&P 500 started to move higher. In fact, year after year earnings moved higher.



Wall Street analysts, either ignorant or lazy, began simply to extrapolate earnings forward as if they would head higher forever. Price/earnings moved higher in line with the analysts hazy thinking. Finally, we saw the P/E's on the S&P rise above the previous high of 20 to 22, 24 and finally to 25.

Wall Street continued to urge investors to be in the market "for the long haul." The message caught on, even though, ironically, it was gauging (CNBC) corporations by their quarterly earnings. The pressure to meet or surpass quarterly earnings led chief financial officers to squeeze every last nickel out of profits, and some of these "profits" were highly questionable. The "bettering profits by a penny" became so common that it ended up as a ridiculous joke.

Next, stocks began to discount a broad decline in profits. Stocks were selling at absurd prices and priced for "rising profits forever." But these same stocks would fall apart if they couldn't meet "analysts expectations." Stocks were priced for perfection and price/earnings had reached their highest levels in history. It was even said the tech stocks were immune to the normal business cycles.

This placed the market in a nightmare position. It was priced for ever-climbing earnings, it was priced for accelerating future earnings, and suddenly the party was over. The result – stock after stock crashed.

In the meantime, the S&P, adding tech stock after tech stock, became highly weighted for techs. As the Nasdaq crashed the S&P sagged badly. The tech side of the S&P, ironically, went a long way toward sinking the S&P 500.

Yet the so-called "old economy" stocks, the Dow-type stocks, tended to hold or to give ground grudgingly. Even so, the Dow was priced at 20 times earnings accompanied by average dividend yields of a mere 1.6%.

In March 2001 the Dow took a swan dive, first breaking below the December low of last year and then breaking below the extreme low of last year. In breaking below the low of the preceding year, the Dow did something that it had not done in 19 years. The die was cast. The bear market became fact – it was finally recognized by the media. The bear (or bear talk) graced the covers of *Newsweek, Time, Fortune, Business Week.*

I note that now the "conventional wisdom is that yes, the bear market is fact, but by the end of this year stocks will still be higher, and in 2002 we'll be back in "goldilocks land" again.

I just received the latest copy of S&P's "The Outlook" weekly report. Here's how it ends: "We don't know if a bottom has been reached. But even if it hasn't, the odds still favor higher prices by year end." And from the latest Morgan Stanley report: "S&P 500 earnings should rise 4% in 2001 and about 14% in 2002."

The job of the big brokerage houses now is to keep their clients from selling out and leaving. So why not be bullish? Why not indeed?

WHY FUNDAMENTALS? Question: "Russell, if the story is in the averages and in stock action, why should investors bother with fundamentals at all?"

Answer: I write these Letters on three levels. (1) What is the market doing? (2) What should we, as investors, do about it? And (3) what's the story behind the market action?

(1) As to the first, I do believe the real story is in market action. Dow Theory's first principle is that "Everything that everyone knows about their own business and the economy is contained in the stock averages. Therefore, what everyone knows is vastly more important that what any single person or group of people know."

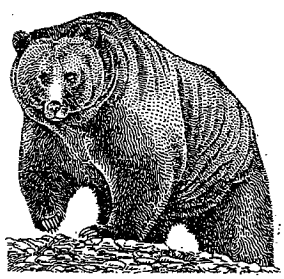
Thus, it comes down to our ability to interpret the movements of the market correctly. This is not an easy task – but there simply is no substitute. I've often said that the art of "reading" the market is knowing what devices and concepts to include and what to throw out.

(2) I write about investing and where I believe our money should go because I believe this may be of help to some subscribers. I usually tell subscribers where I have put my own money. However, there's no substitute for common sense and study. You may want to be in cash during a bear market, I may want to be mostly in bonds, a third party may want to be heavily in euro CDs. All three positions are defensive, no one person has the ultimate answer, and what suits one person on an emotional basis may be "impossible" to the next person.

(3) I read voluminously for two reasons. First, I read about the economy, about business and about stock fundamentals because I'm fascinated. I also believe that as an American, it's my duty to inform myself. Democracy depends on an informed electorate. How can we vote intelligently if we don't know the issues and if we don't know what's happening?

A second reason to take in the fundamentals is "contrary opinion." When too many people believe the same thing, you can assume that that "same thing" has been fully discounted by the market.

INVESTMENT POSITION: Last week I had a debate with a fellow who's in charge of a great deal of money. We had a friendly debate. The fellow held that stock buy-backs (corporations that buy back their own stock) are superior to stocks that pay dividends. I argued the opposite.



I said that when I buy a stock I want a return on my money. If I receive a dividend, that's a tangible return. I can spend the dividend, I can save it, but most importantly I can use that dividend to diversify and to compound. Without a dividend, there's no way I can compound, and I'm a nut on compounding. Compounding, I told my friend, is the "royal, safe way to wealth."

I cited the situation today where many stocks (and many good stocks) have topped out and are now selling for just fractions of their peak prices. The person who owns say a Microsoft or an Intel or a Yahoo, where are they now, with their stock in the dumps? And what did they get for their waiting?

As far as I'm concerned, all they got was a headache. The stocks never paid them anything in the way of dividends, they now are holding these stocks with losses, and what kind of return did they get for their waiting? Their return -- zero, nada, zip, nothing.

All of which highlights the advantage of a stock that pays a dividend. I don't want to buy a stock – and then find myself HOPING (there goes that word again) that my stock will go up. I want a dividend and then it would be "nice" if the stock would go up.

But a safe, steady stream of dividends over the years erases a lot of worry and a lot of agony. I only buy stocks with dividends. I learned that the hard way – by the way, stocks that pay dividends can also go up.

NOTES & QUOTES: Ever since I started putting my daily comments on the Internet, I've been urging subscribers to "tune in" and get these daily updates. We now have well over 5,000 subscribers hitting the site, and I'm again urging all subscribers who have the capabilities of getting on the net to read my daily output.

I placed the following on my web site on March 23, but it's important enough so that I want my non-web subscribers to read it.

If you watch CNBC you may occasionally see one of my favorite technicians and stock market analysts, Jerry Favors. Jerry goes strictly by the numbers, and he leaves his emotions out of his studies. He's also a very serious analyst who has done his homework.

The following is from his last report dated March 12, at which time Jerry was still bullish: "The intraday low in October of last year was 9571 in the Dow. If that level is broken at any time this year, it will turn an important Gann Yearly Chart down for the first time in the last 19 years. If that were to occur we believe the entire bull market from 1982 will be over." The *Jerry Favors Analysis,* 614 840 0364.

Russell Comment: The Dow closed on March 22, 2001, at 9389.48.

* *

The competition between Europe's Airbus (a consortium of German, French, Spanish and British companies) and the US's Boeing is shaping up as the world's most bitter commercial battle. It involves huge egos, tens of billions of dollars and a race to market the latest aeronautics technology.

Airbus's A380 will be the biggest European collaborative project ever undertaken, bringing together millions of parts with a watchmakers precision. This will require vast new industrial installations in Toulouse and Hamburg, with projected development costs of $10.7 billion. The project will be a symbol of European pride.

Airbus will challenge the Boeing 747, the largest single industrial source of export dollars in the US, and it's a symbol of US leadership.

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Making movies is becoming ridiculously expensive. The latest data shows that the average cost to market a major studio film has risen to a record $82.1 million, up 8% from the $76 million it cost in 1999. Studios in 2000 released 191 films as against 213 in 1999.

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What's the biggest California horticultural export? It's almonds. Cal grows and ships 80% of the world's almonds. Almonds are a billion dollar business. Cal's exports of almonds are 30% bigger than its shipments of wine and 130% bigger than its shipments of orange juice. Almonds are a big source of vitamin E in the form of anti-oxidant Alpha-Tocopherol. I eat about 8 almonds a day. I am convinced that they are very good for you.

* *

I've always wondered why California allows tens of thousands of Californians to go Las Vegas and spend their money, the taxes from which go to the state of Nevada.

Now Nevada's "gaming" corporations are worried that Cal will pass a law this year which will enable Indians without tribal land to acquire gambling licenses in non-tribal premises, including urban areas such as Los Angeles. I think it's only a matter of time before the current Indian gambling casinos within Cal will enlarge to become tough competition with the Nevada casinos. Currently, over a third of Las Vegas' visitors come from Cal. Interestingly, over two-thirds of Las Vegas' population of 1.3 million are directly or indirectly dependent on gambling for their income.

* *

The *Economist* magazine looks for "worsening conditions in the Japanese and American economies, and a comparatively cheerful outlook for Europe." Russell Comment: I'm not so sure. As the bear market deepens, we'll see whether Europe holds up better than the US and Japan. The best barometer may be the action of the dollar against the euro.

Actually, Japan faces a long-term decline as a major world power. Japan's emergence as a great power following WW II resulted from three factors, a stable political system, a booming population and a close relationship with its old enemy, the US.

But now Japan's political system is proving to be bureaucratic and ineffective, and its populace has lost faith in the government. As for demographic forecasts, Japan's current population of 126 million is forecast to drop to 100 million by 2050 – that is, unless fertility rates turn up or immigration makes up for the projected decline in the population. Meanwhile, Japan's population is aging rapidly. It all adds up to a long-term decline in Japan's power.

* *

Volume is contracting for brokers. Datek online announces that volume for February dropped a large 28% from the previous month. These are the lowest figures for Datek since last August. Other outfits will be reporting, but Datek was the first.

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You want to bet on the euro against the dollar? You can do it via a new service offered by Everbank, the Internet bank. They offer no-load CD's that are FDIC insured and in a number of different currencies. See their website, www.everbank.com.

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From the *WSJ*: "Due to declining stock prices, household net worth declined for the first time in at least 55 years."

* *

Differences: In a bull market your expensive laundry calls to tell you that "We're really sorry, we lost your shirt." In a bear market it's your financial advisor who calls to tell you that "We're really sorry, you lost your shirt."

* *

Holding for the long term for recouping your losses. This from Gretchen Morgenson's *New York Times* article. "Take a popular stock like Intel, which has fallen 63% from its high of $75.81 in August. Many investors feel that Intel's dominance in microprocessing makes it a prime comeback candidate.

"Assume that Intel's shares rise 15% a year going forward, an enviable return by any investor's reckoning. How long would it take to get back to their highs of just seven months ago? Seven long years.

"Plug in the same assumptions of 15% annual returns for the rest of the most popular shares in America and the picture is sobering indeed. These stocks may certainly come back, but if they do, it will more likely be over a period of years, not months.

"At 15% a year, Cisco shareholders would need to wait a decade for their stock to get to its high of $82 seen last March. AT&T would climb back to its peak of last March

in seven years. GE, which has lost a relatively modest 33% since its peak of last August would need three years to return there."

* *

Do people want to escape state taxes? You be the judge. From 1980 to 1990 the population of Nevada (the US's fastest growing state by far) increased by 50.1%. Was that enough? Hardly, from 1990 to 2000 the population of Nevada increased by 66.3%. Four out of five newcomers settle in Las Vegas. But Henderson, Nevada grew faster than Las Vegas, up 170% from 1990 to 2000 whereas Las Vegas "only grew" 85% (but Henderson is very near Las Vegas). Oh, by the way, Nevada has no personal or corporate tax.

* *

Sign of the times: Lespinassse, one out of only six four-star restaurants in NYC, recently closed for lunch because (according to *Crain's New York*) "its wealthy patrons no longer want to spend the time lingering over a noontime meal, especially when the Dow's gyrations are causing indigestion."

GOLD: The interest in gold is still here, despite a twenty-year bear market. Why? Because a lot of us still believe that gold is the only real money. And just as important, because many of us lived through the great precious metals market of 1975-1980, and we're thinking – "Maybe it will happen again – well, maybe."

But there's even another reason, and it's that we know that the purchasing power of the dollar is being systematically undermined by the Fed. And ultimately, goes the gold argument, the dollar and all paper currencies will collapse – and gold will emerge triumphant. Anyway, that's the theory. In practice, it hasn't happened yet – to put it mildly.

Where is gold now? The June futures hit a closing low of 259 on February 15. A sharp rally then shot June gold up to 274 on March 12. From there, gold has fallen apart, and June gold is now testing the lows again. As I write this, June gold is at 259.90. There seems to be little real buying interest in gold. Rallies, declines, rallies, declines, but the metal and the gold stocks never seem to get anywhere. The action has worn most of the metals fans and rooters out. Why fight it? I'm still holding my gold coins and waiting for the big move that never comes. Is faith in gold a religion or a reality? We'll surely find out. Gold bugs pose this question, "Is there any possible way that 150 central banks can be right?"

LATE NOTES: When you come right down to it, the difference between the bulls and the bears is as follows: the bulls believe that Greenspan and the Fed have the power to halt the bear market, and that they have the power to send stocks and the economy back towards the highs.

The bears believe that the markets are going to go where they want to go, and that the bear market will fully express itself -- regardless of the Fed's manipulations.

I belong to the second group. I believe that the primary trend is more powerful than the combined strengths of the Federal Reserve, the Treasury, both houses of Congress and the Presidency.

Last week a subscriber asked, "OK, Russell, I agree with you – it's a bear market. So what's the worst that can happen?" I told him the worst would be that the Dow declines to touch its longest rising trendline, an unthinkable but not impossible scenario. That would give us a Dow of around 2500. The story, in chart form, is below.

NEXT MAILING: April 25, 2001